

BEFORE THE
BOARD OF ACCOUNTANCY
DEPARTMENT OF CONSUMER AFFAIRS
STATE OF CALIFORNIA

In the Matter of the Accusation)
Against:)

WARREN H. BAKER)
333 North Lantana Street)
Suite 269)
Camarillo, California 93010)

No. AC-95-29
OAH No. L-9606116

Certificate No. 8562,)
Respondent.)
_____)

DECISION

The attached Proposed Decision of the Administrative Law Judge is hereby adopted by the Board of Accountancy as its decision in the above-entitled matter.

This Decision shall become effective MAY 2, 1997.

IT IS SO ORDERED APRIL 2, 1997.

BOARD OF ACCOUNTANCY
DEPARTMENT OF CONSUMER AFFAIRS
STATE OF CALIFORNIA

By 

rfm

BEFORE THE
BOARD OF ACCOUNTANCY
DEPARTMENT OF CONSUMER AFFAIRS
STATE OF CALIFORNIA

In the Matter of the Accusation)	No. AC-95-29
Against:)	
)	OAH No. L-9606116
WARREN H. BAKER)	
333 North Lantana Street)	
Suite 269)	
Camarillo, California 93010)	
)	
Certificate No. 8562,)	
)	
Respondent.)	
)	

PROPOSED DECISION

This matter came on regularly for hearing before Ralph B. Dash, Administrative Law Judge with the Office of Administrative Hearings on January 30 and 31, 1997, at Los Angeles, California.

Complainant was represented by Michael Shekey, Deputy Attorney General.

Respondent was present and represented himself.

Oral and documentary evidence having been received and the matter submitted, the Administrative Law Judge makes the following Findings of Fact.

FINDINGS OF FACT

1. Complainant Carol B. Sigmann is the Executive Officer of the California Board of Accountancy ("Board") and made the Accusation solely in her official capacity.

2. On December 10, 1960, Certificate Number 8562 was issued by the Board to Warren H. Baker ("Respondent"). Said certificate is currently in full force and effect, and expires subject to renewal on April 1, 1997.

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3. On or before April 22, 1992, Respondent performed an audit of the Balance Sheet of B.V. Beheermaatschappij Uis ("BVB") as of January 1, 1992. BVB was a newly formed "off-shore" reinsurance company. At the time the audit was being performed, Respondent was the Vice-President of Administrative Services of Attorneys Title Company ("ATC") which was the company with whom BVB had a \$100,000,000 receivable and payable, which was the only significant asset and liability of BVB. This receivable and payable was part of a financing scheme between BVB and ATC that used reciprocal debentures that appeared to inflate the actual status of BVB's capital account.

4. The audit of BVB contained extreme departures from generally accepted auditing standards (GAAS). As more fully discussed below, the departures from GAAS include the following:

a. Respondent issued an opinion on the BVB financial statement even though he was not independent.

b. Respondent failed to provide documentation which would demonstrate that the audit was adequately planned.

c. Respondent failed to provide documentation which would reflect his understanding of the internal control structure and the assessed level of control risk associated with the related auditing procedures.

d. Respondent failed to provide documentation that he assessed the risk that error and irregularities may have caused the Financial Statement to have contained a material misstatement.

e. Respondent failed to obtain sufficient competent evidential matter so as to afford a reasonable basis for his opinion regarding the financial statement audited.

f. Respondent failed to exercise due professional care in that he failed to maintain a healthy skepticism in the conduct of the audit in light of his knowledge of the parties that engaged him to do the audit, and in that he failed to meet the three standards of field work that require (1) planning, (2) evaluation of internal control, and (3) review of sufficient competent evidential matter.

5. A review of the BVB balance sheet and Respondent's audit working papers show the following:

a. The working papers appear to be more like a correspondence file than audit working papers.

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b. BVB's principal asset is \$100 million in debentures receivable from ATC which, by Respondent's admission, were never issued.

c. There is no evidence in the working papers that indicates verification of security, as disclosed in the footnotes, for the debentures receivable.

d. BVB's other assets were earned premiums receivable of \$114,733, for which an independent confirmation by Respondent was not located in the working papers, \$7,660 in cash which was confirmed by Respondent by telephone, \$5,000 in prepaid expenses, and \$1,099 in office equipment. There is no mention of the prepaid expenses or office equipment in the working papers.

e. BVB's only liabilities are \$100 million in debentures, subordinated to reinsurance claims against BVB and payable to ATC only out of after-tax profits of BVB, which makes this very close to capital, rather than liabilities. There is no evidence in the working papers that such debentures were issued.

The debentures receivable by BVB from ATC cannot be offset against the debentures payable to ATC. The balance sheet appears to show that there is \$100 million available for reinsurance claims, the only significant liabilities this type of enterprise would be expected to have. The balance sheet can be easily interpreted to the effect that BVB has \$100 million in equity, making it appear substantial, when in fact it was essentially a shell corporation.

6. The person in charge of ATC was an old friend of Respondent's, Joseph Laird Jr., for whom he had performed various accounting services related to legal issues for ATC off and on since 1990. Respondent's relationship with Mr. Laird and ATC is somewhat bizarre. Respondent was ATC's landlord and, although Mr. Laird was clearly in charge of the ATC/BVB transaction, Respondent borrowed funds on his own to help pay Mr. Laird's expenses.

In a deposition taken during Bankruptcy proceedings in 1992, Respondent stated that he was the Vice President of Administrative Services for ATC and had employed Joseph Laird as assistant director of administrative services since approximately June 1991. The position that Respondent held with ATC and his rather unusual relationship with Mr. Laird, clearly results in a lack of independence for the purpose of his auditing BVB, particularly since the single largest asset and corresponding liability of BVB was with ATC. Furthermore, Respondent did not receive a fee for this audit. He was not engaged by BVB to perform the audit, rather, since he was employed by ATC, he performed the audit of BVB without additional compensation. This further demonstrates his lack of independence.

7. The deposition shows a highly complex set of corporate structuring that all lead to Joseph Laird's control of ATC and Respondent's knowledge of those relationships. Respondent has known Joseph Laird since 1962 and was in contact with him regarding the various ATC related entities in mid-1990, after Laird was released from prison for the crimes described below. It was through Joseph Laird that Respondent obtained the BVB/ATC engagement.

On July 30, 1984, Mr. Laird was convicted, after trial, of a total of 8 counts of conspiracy to defraud the government (IRS); counseling and procuring the filing of false tax returns, and submitting false income tax documents to the IRS. Mr. Laird was sentenced to four years in prison and fined \$40,000. He also resigned from the State Bar. Respondent was fully aware of Mr. Laird's criminal past and thus should have been particularly alert for any irregularities during his conduct of the audits.

8. The second general standard of auditing principles as set forth by GAAS is:

In all matters relating to the assignment, an independence in mental attitude is to be maintained by the auditor.

This standard requires that the auditor be independent; aside from being in public practice, he must be without bias with respect to the client since otherwise he would lack that impartiality necessary for the dependability of his findings, however excellent his technical proficiency may be.

When an accountant is not independent, any procedures he might perform would not be in accordance with generally accepted auditing standards, and he would be precluded from expressing an opinion on such statements. Accordingly, he should disclaim an opinion with respect to the financial statements and should state specifically that he is not independent, which Respondent clearly was not as set forth above in paragraph 6.

9. The first standard of fieldwork, as set forth by GAAS, provides that the work is to be adequately planned and assistants, if any, are to be properly supervised.

The standard requires that the auditor consider, among other things:

(1) Matters relating to the entity's business and the industry in which it operates;

(2) Planned assessed level of control risk;

(3) Preliminary judgement about materiality levels for audit purposes;

(4) Conditions that may require extensions or modification of audit tests, such as the risk of material errors or irregularities or the existence of related party transactions.

In addition the working papers should include documentation showing that the work has been adequately planned.

An assessment of the risk of material misstatements should be made during planning. The factors considered in assessing risk include management characteristics, operating and industry characteristics, and engagement characteristics. Knowledge of the offshore insurance industry, which Respondent totally lacked, would also have led the auditor to beware of fraudulent transactions.

10. Respondent did not develop an overall strategy for the expected conduct and scope of the audit. There was no evidence of audit planning, such as an audit program, or any consideration given to the audit objectives or anticipated procedures.

Respondent did not consider conditions that may require extension or modification of audit tests, such as risk of material errors or irregularities or the existence of related party transactions, even though Respondent was fully aware of fraudulent behavior by significant related parties.

Respondent did not consider a planned level of control risk.

Respondent did not plan or perform the audit with an attitude of professional skepticism. He gave no consideration to the integrity of management, although he was fully aware of the judgements against ATC, as well as Mr. Laird's felony convictions.

11. The second standard of field work as set forth by GAAS states,

There is to be a proper study and evaluation of the existing internal control as a basis for reliance thereon and for the determination of the resultant extent of the tests to which auditing procedures are to be restricted.

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In all audits, the auditor should obtain a sufficient understanding of each of the three elements of internal control to plan the audit, by performing procedures to understand the design of policies and procedures relevant to audit planning and whether they have been placed in operation. Documentation of that understanding of the internal control structure is specifically required.

An auditor is also required to document the basis for his conclusions about the assessed level of control risk.

The auditor's understanding of the internal control structure may sometimes raise doubts about the auditability of an entity's financial statements. Concerns about the integrity of the entity's management may be so serious as to cause the auditor to conclude that the risk of management misrepresentations in the financial statements is such that an audit cannot be conducted.

12. Respondent did not document his understanding and consideration of the elements of internal control. Although BVB was relatively inactive, an auditor would be expected to memorialize his consideration of the internal control structure in a memo. There was no evidence relative to the consideration of internal control in Respondent's working papers. There was no evidence that Respondent made an evaluation or came to any conclusions regarding the three elements of internal control: the control environment, the accounting system, and control procedures. There was no evidence whatsoever that Respondent assessed the level of control risk or Mr. Laird's criminal past.

13. The third standard of field work set forth in GAAS states that:

Sufficient competent evidential matter is to be obtained through inspection, observation, inquiries, and confirmations to afford a reasonable basis for an opinion regarding the financial statements under audit.

Most of the independent auditor's work in forming an opinion on financial statements consists of obtaining and evaluating evidential matter concerning the assertion in such financial statements.

Working papers should document the observance of the standards of field work. Working papers provide the principle support for the auditor's report (opinion), including his or her representation regarding the observance of the standards for field work, which is implicit in the reference in his or her report to generally accepted auditing standards. Accordingly, working papers should not consist solely of audit programs or

checklists on which the auditor has indicated that the steps have been performed. Working papers should identify the nature, source and amounts of accounting entries or financial items tested, and the related evidential matter examined.

14. The balance sheet of BVB appears questionable in that 99% of the asset balance is attributable to one item, \$100,000,000 in debentures receivable from ATC, and 99% of the liability and equity balance is attributable to a corresponding \$100,000,000 debentures payable to the same organization, ATC. Respondent's working papers contained unsigned and undated agreements related to this transaction. While there were draft copies of the debenture notes, there was no evidence to support management's assertion of existence or issuance of these items, or any rights and obligations thereunder.

15. The third general standard of auditing principles, as set forth by GAAS, states that:

Due professional care is to be exercised in the performance of the examination and the preparation of the report.

This standard requires the independent auditor to perform his work with due professional care. Due care imposes a responsibility upon the auditor to observe the standards of field work and reporting.

16. From the onset of the audit, Respondent did not exercise due care in that he failed to maintain a healthy skepticism in the conduct of the audit which should have resulted from his knowledge of the parties that engaged him to do the audit.

Respondent claimed that he never intended to release the audit report, and did so only on a "pro forma" basis with limited circulation. This assertion is contrary to the evidence and is flatly rejected. Respondent clearly released the audit and just as clearly, intended to do so. He did not exercise due care in completing the audit requirements prior to issuance of the report in that he failed to meet the three standards of field work that require: planning, evaluation of internal control, and sufficient competent evidential matter, as detailed above.

17. The GAAS standard for independence of an auditor is set forth in paragraph 10 above. Respondent again violated this standard in connection with his audit of ATC.

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Respondent performed an audit of the balance sheet of ATC at or about the same time as the audit of BVB. At the time the audit was being performed, Respondent was the Vice-President of Administrative Services of ATC. Nevertheless, Respondent issued an opinion on the financial statement even though he was not independent of ATC, and in fact was intimately involved in all of its affairs.

18. Respondent submitted a list of 109 hours of continuing education for the license renewal period ended March 31, 1993, but failed to provide any documented evidence of completion of the course requested on the aforementioned list. By utilizing outside sources, the Board was able to confirm completion of only 11 hours of qualified continuing education. Respondent admitted he could not afford to pay for many of the classes he listed, but asserted he nevertheless attended the same, albeit without credit. Even if true, this does not meet regulatory requirements for continuing education.

19. On or about January 11, 1996, the Board requested from Respondent a list of the 80 hours of qualified continuing education completed by him for the period ended March 31, 1995.

On or about January 19, 1996, Respondent submitted documented evidence of 130 hours of education purportedly for the period ended March 31, 1995. The certificates of completion, however, reflected that none of the referenced courses were completed until after March 31, 1995. Respondent admitted to this fact with his accompanying transmittal letter, dated January 19, 1996, as well as in his testimony. Furthermore, the course material concentrated in one area only, real estate law, which may not even have qualified as appropriate continuing education. Respondent also indicated within this transmittal letter his intention to "carry over" 50 hours of the 130 hours completed to the following renewal period, which the regulations do not permit.

20. Respondent has been a Board licensed Certified Public Accountant for more than 36 years. He has spent a large portion of his career performing public school audits. He appears gentlemanly, almost courtly, has no prior disciplinary history, and desires to retrain his licensed status in any from the Board deems appropriate. However, Respondent's conduct, as set forth above, clearly shows the harm to the public that could befall it were Respondent to retain his licensed status.

What became especially clear during the trial of this matter is that Respondent had absolutely no idea of the huge fraud potential represented by ATC/BVB transaction. In fact, Respondent did not even understand, (or at least could not explain), the transaction, which was nothing more than the formation of a shell company (BVB) with phony balance sheets

indicating \$100,000,000 in viable assets, set up to go into the re-insurance business, when it actually had no viability whatsoever. Respondent was ill used by his friend, Joseph Laird. Yet Respondent ignored his overriding duty as a Board licensee to perform his work in a detached, professional manner; regardless of the cause, this breach was inexcusable.

21. The Board reasonably incurred costs of investigation and prosecution of the within action, including attorneys fees, in the total sum of \$24,654.16. Through his testimony, Respondent established that he could not pay this, or any other sum, inasmuch as he now lives on a meagre practice and social security income. Furthermore, in light of the below order, it would pose unreasonable financial hardship to assess Respondent with any order for cost recovery, even on a payment plan basis.

22. Except as expressly found herein to be true, any remaining changing allegations of the Accusation are found to be unproven by clear and convincing evidence.

Pursuant to the foregoing Findings of Fact, the Administrative Law Judge makes the following Determination of Issues:

1. Respondent committed acts of gross negligence in his preparation and issuance of the BVB and ATC audits, in violation of Business and Professions Code § 5100(c), and Title 16, California Code of Regulations §65, by reason of Findings 2 through 17, thereby subjecting his license to discipline.

2. Respondent violated the provisions of Title 16, California Code of Regulations §§87(a) and 89, by reason of Findings 18 and 19, thereby subjecting his license to discipline.

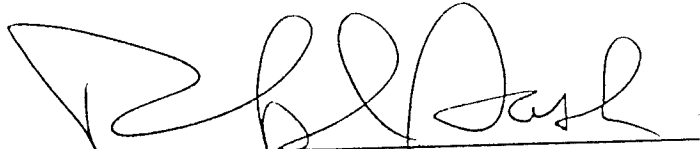
3. The Board reasonably incurred costs of investigation and prosecution of this action, including attorneys, in the total sum of \$24,654.16. However, in light of Respondent's financial hardship and the severity of the order issued below, the costs and attorney's fees incurred will not be assessed against Respondent, by reason of Finding 21, pursuant to the provisions of Business and Professions Code §5107(c), (e) and (f).

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WHEREFORE, THE FOLLOWING ORDER is hereby made:

Certificate number 5862, issued to Respondent Warren H. Baker, together with all licensing rights appurtenant thereto, is revoked.

Dated: Feb 25, 1997

A handwritten signature in black ink, appearing to read "R B Dash", written over a horizontal line.

RALPH B. DASH
Administrative Law Judge

RBD:rfm

1 DANIEL E. LUNGREN, Attorney General
of the State of California
2 MICHAEL A. SHEKEY, State Bar # 143436
Deputy Attorney General
3 300 South Spring Street, 10 North
Los Angeles, California 90013
4 Telephone: (213) 897-2520

5 Attorneys for Complainant

6
7 BEFORE THE
BOARD OF ACCOUNTANCY
8 DEPARTMENT OF CONSUMER AFFAIRS
STATE OF CALIFORNIA
9

10
11 In the Matter of the Accusation) NO. AC-95-29
Against:)
12) ACCUSATION
WARREN H. BAKER)
13 333 North Lantana Street)
Suite 269)
14 Camarillo, California 93010-9008)
15 Certificate No. 8562,)
16 Respondent.)
17)

18 Complainant, Carol B. Sigmann, as cause for
19 disciplinary action, alleges:

20 1. Complainant Carol B. Sigmann ("Complainant") is
21 the Executive Officer of the California Board of Accountancy
22 ("Board") and makes and files the Accusation solely in her
23 official capacity.

24 LICENSE STATUS

25 2. On or about December 10, 1960, Certificate
26 Number 8562 was issued by the Board to Warren H. Baker
27 ("Respondent"). Said Certificate is currently in full force and

1 effect, and expires subject to renewal on April 1, 1997.

2 STATUTES

3 3. This Accusation is made in reference to the
4 following statute of the California Business and Professions Code
5 ("Code").

6 a. Section 5100 provides that the Board may
7 revoke, suspend or refuse to renew any permit or
8 certificate issued by the Board, or may censure the
9 holder of any such permit or certificate for
10 unprofessional conduct which includes, but is not
11 limited to, one or any combination, of the following:

12 (c) Dishonesty, fraud, or gross negligence in the
13 practice of public accountancy.

14 (f) Willful violation of this chapter or any rule or
15 regulation promulgated by the board under the authority
16 granted under this chapter.

17 REGULATIONS

18 4. This Accusation is made in reference to the
19 following regulations of the California Code of Regulations,
20 Title 16 ("Regulation"):

21 a. Section 65 provides that a licensee shall not
22 express an opinion on financial statements unless the
23 licensee is independent with respect to such
24 enterprise.

25 b. Section 87(a) provides that a licensee shall
26 not engage in public practice unless during the two-
27 year period immediately preceding permit renewal the

1 licensee has completed at least 80 hours of qualifying
2 continuing education and submitted the statement required by
3 Section 89.

4 c. Section 87(b) provides that for licenses renewed on
5 or after January 1, 1991, a licensee who is responsible for
6 planning, directing, reporting, or conducting substantial
7 portions of field work on any financial or compliance audit
8 report on a government agency shall be required to complete
9 a minimum of 24 hours of the 80 qualifying hours of
10 continuing education in the areas of governmental accounting
11 and auditing or related subjects during the two-year period
12 preceding the license renewal period. * * * Related subjects
13 are defined as courses which improve knowledge of
14 governmental operations, laws, regulations, reporting or
15 other special requirements. Licensees shall report
16 continuing education at the time of renewal on Form 11R-14A,
17 revised 11/87, available from the Board.

18 d. Section 89 provides that all licensees shall
19 maintain their records confirming attendance at and
20 completion of continuing education.

21 e. Section 89(f) provides that a licensee's willful
22 making of any false or misleading statement, in writing,
23 regarding his or her continuing education shall constitute
24 cause for disciplinary action pursuant to section 5100(f) of
25 the Accountancy Act.

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1 AUDIT OF THE BALANCE SHEET OF B.V. BEHEERMAATSCHAPPIJ UIS

2 5. Respondent performed an audit of the Balance Sheet
3 of B.V. Beheermaatschappij Uis ("BVB"). At the time the audit
4 was being performed, Respondent was the Vice-President of
5 Administrative Services of Attorneys Title Company. Attorneys
6 Title Company was the company with whom BVB had a \$100,000,000
7 receivable and payable, which was the only significant asset and
8 liability.

9 6. As a result of the conduct described in
10 paragraph 5, Respondent is subject to discipline under California
11 Business and Professions Code, Section 5100 (c), Gross
12 Negligence, in that his audit of BVB contained extreme departures
13 from generally accepted auditing standards (GAAS). The
14 departures from GAAS include, but are not limited to, the
15 following:

16 a. Respondent (Auditor) issued an opinion on the
17 Financial Statement even though he was not independent.

18 b. Respondent (Auditor) failed to provide
19 documentation which would demonstrate that the Audit was
20 adequately planned.

21 c. Respondent (Auditor) failed to provide
22 documentation which would reflect his understanding of the
23 internal control structure and the assessed level of control
24 risk associated with the related auditing procedures.

25 d. Respondent (Auditor) failed to provide
26 documentation that he assessed the risk that errors and
27 irregularities may have caused the Financial Statement to

1 have contained a material misstatement.

2 e. Respondent (Auditor) failed to obtain sufficient
3 competent evidential matter so as to afford a reasonable
4 basis for his opinion regarding the Financial Statement
5 under audit.

6 f. Respondent (Auditor) failed to exercise due
7 professional care in that he failed to maintain a healthy
8 skepticism in the conduct of the audit as a result of his
9 knowledge of the parties that engaged him to do the audit,
10 and in that he failed to meet the three standards of field
11 work that require (1) planning, (2) evaluation of internal
12 control, and (3) review of sufficient competent evidential
13 matter.

14 AUDIT OF THE BALANCE SHEET OF ATTORNEYS TITLE COMPANY

15 7. Respondent performed an audit of the Balance Sheet
16 of Attorneys Title Company ("ATC"). At the time the audit was
17 being performed, Respondent was the Vice-President of
18 Administrative Services of ATC.

19 8. As a result of the conduct described in
20 paragraph 7, Respondent is subject to discipline under California
21 Business and Professions Code, Section 5100 (c), Gross
22 Negligence, in that his audit of ATC contained extreme departures
23 from generally accepted auditing standards (GAAS). The
24 departures from GAAS include, but are not limited to, the
25 following:

26 a. Respondent (Auditor) issued an opinion on the
27 Financial Statement even though he was not independent.

1 FAILURE TO COMPLY WITH CONTINUING EDUCATION
2 REQUIREMENTS FOR PERIOD ENDED MARCH 31, 1993

3 9. Respondent submitted a list of 109 hours of
4 continuing education for the license renewal period ended
5 March 31, 1993, but failed to provide any documented evidence of
6 completion of the course requested on the aforementioned list.
7 By utilizing outside sources, the Board was able to confirm
8 completion of only 11 hours of qualified continuing education.

9 10. As a result of the conduct described in
10 paragraph 9, Respondent is subject to discipline under
11 sections 87(a) and 89 of the California Code of Regulations,
12 Title 16.

13 FAILURE TO COMPLY WITH CONTINUING EDUCATION
14 REQUIREMENTS FOR PERIOD ENDED MARCH 31, 1995

15 11. On or about January 11, 1996, the Board requested
16 from Respondent a list of the 80 hours of qualified continuing
17 education completed by him for the period ended March 31, 1995.

18 12. On or about January 19, 1996, Respondent submitted
19 to the Board documented evidence of 130 hours of education
20 purportedly for the period ended March 31, 1995. The License
21 Renewal Application that was executed by Respondent on April 24,
22 1995, under penalty of perjury, indicated that he had performed
23 governmental audit work and had completed 40 hours of
24 governmental education. The certificates of completion, however,
25 reflected that all of the referenced courses were not completed
26 until after March 31, 1995. Respondent admitted to this fact
27 within his accompanying transmittal letter, dated January 19,

1 1996. Respondent also indicated within this transmittal letter
2 his intention to carry over 50 hours of the 130 hours completed
3 to the following renewal period.

4 13. On January 29, 1996, confirmation was provided by
5 the State Controller's Office, Single Audit Unit, indicating that
6 Respondent had performed governmental audits during the renewal
7 period ended March 31, 1995.

8 14. As a result of the conduct described in paragraph
9 12, Respondent is subject to discipline under sections 87(a),
10 87(b), and 89(f) of the California Code of Regulations, Title 16,
11 and under section 5100(f) of the California Business and
12 Professions Code.

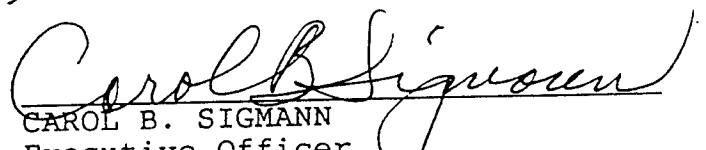
13 WHEREFORE, Complainant requests that a hearing be held
14 on the matters alleged herein, and that following said hearing, a
15 decision be issued:

16 1. Revoking or suspending Certificate Number 8562
17 heretofore issued to Respondent Warren H. Baker;

18 2. Directing Respondent Warren H. Baker to pay to the
19 Board a reasonable sum for its investigative and enforcement
20 costs of this action, including attorney's fees; and,

21 3. Taking such other and further action as the Board
22 deems proper.

23 DATED: April 8, 1996

24
25 
26 CAROL B. SIGMANN
27 Executive Officer
Board of Accountancy
Department of Consumer Affairs
State of California